Financial Markets

Irving Trust

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With the books fully closed on 1983, it is useful to look back and assess the Fed's policy moves. By examining the Fed's original policy intentions of last year, the actual course taken, and the results produced, we can better see the hard choices for monetary policy in 1984.

First, the pure postmortem: The Fed hit all of its targets for the year. M1 closed out very near the bottom of the range that was laid out at midyear. M2 similarly languished in the lower quartile of its range. M3 remained at the top of its target. Thus the Fed's policies resulted in targets that could be hit (after some midyear jiggering) and an excellent economic performance: The economy has expanded just as rapidly in this recovery as it usually does in recovery periods. At year-end, we find the super-heated growth of the early recovery period decelerating but the economy showing substantial growth--a very good situation. Inflation remains well in check.

The Fed began the year uncertain about the course of monetary policy. Financial innovation was clearly going to disturb M2. The impact on M1 and M3 was much less certain. M3 seemed likely to be little affected. M1 had been behaving bizarrely even before the new super NOW bank accounts were introduced. The recent behavior of M1 is best characterized by its highly unusual velocity performance. This had led the Fed to accommodate above-target M1 growth in 1982 and to still feel comfortable in allowing the top of 1983's growth target to rise 8% from that bloated 1982 fourth-quarter base. The Fed was highly sensitive to this situation, however, and laid out its 1983 policy directive as targeting M1 to hit the top or bottom of that wide range "depending on velocity." That was the forward looking aspect of Fed policy.

What happened in early 1983 obviated the need for such a conditional directive. M1 grew so fast (velocity grew so slowly) that the Fed threw out its earlier target, resetting a new and higher base allowing M1 to grow at a 5%-9% rate. Fortunately, M1 did slow its growth. The economy continued to grow. These events produced an increase in M1's velocity--which now begins to look as though it's behaving "normally" once again. So the Fed looks to 1984 with a tentative 4%-8% growth range set for M1 and a legacy of M1 misses--even though it did hit all of its final 1983 targets.

The monetary trade-off, however, is even more complex than this suggests. The Fed also sets interim targets to guide its policies from one FOMC meeting to the next. The last group of targets set for Sept.-Dec. growth rates of the Ms found <u>all</u> the aggregates growing more slowly than their targeted rates. On this basis, the Fed should ease. But the possibility of continued strong recovery and (perhaps) normal M1 velocity growth suggests caution. The election year is a complication: It will make it hard for the Fed to raise rates. Money growth will have to be clearly over target for the Fed to tighten--this argues for lowering the M1 target. But if this is done and velocity does not grow could Fed credibility withstand another miss of an M1 target? I think it could. But whatever the Fed decides, it will tread another narrow path trying both to control the aggregates and to sustain recovery.

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Market Yields

	1/20/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	11.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	9.44	9.31	8.13
Repurchase Agreements	9.30	9.20	8.13
U.S. Treasury Issues			
Bills			
3 months	9.24	9.11	8.16
6 months	9.53	9.47	8.49
1 year	9.89	9.76	8.78
Coupons			
2 years	10.59	10.58	9.36
4 years	11.11	11.14	9.93
7 years	11.53	11.57	10.47
10 years	11.61	11.64	10.51
Long Bond	11.70	11.71	10.74
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.25	9.30	8.10
3 months	9.35	9.35	8.30
6 months	9.50	9.50	8.55
1 year	9.95	10.00	8.85
Banker's Acceptances			
1 month	9.30	9.25	8.05
3 months	9.47	9.35	8.05
6 months	9.64	9.50	8.10
Eurodollar Deposits			
1 month	9.63	9.69	8.88
2 months	9.69	9.81	9.00
3 months	9.81	9.88	9.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.40	9.34	7.11
1 month	9.45	9.35	7.79
3 months	9.49	9.49	8.01
Bank Holding Companies			
1 month	8.94	9.07	7.27
Dealer Placed:			
3 months	9.60	9.58	7.62
New AA Corporate Utility Bond	12.75	12.75	12.65
Tax Exempt			
6 month Project Notes	5.25	5.35	4.60
1 year AAA Bond	5.50	5.35	5.00
5 year AAA Bond	7.00	7.20	6.10
20 year AAA Bond	9.00	9.10	8.60

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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